DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 1759
La Jolla, Calif. 92037

36 Letters per Year – $75 Annually

Registered with the Securities Exchange Commission

December 13, 1972 Letter 549

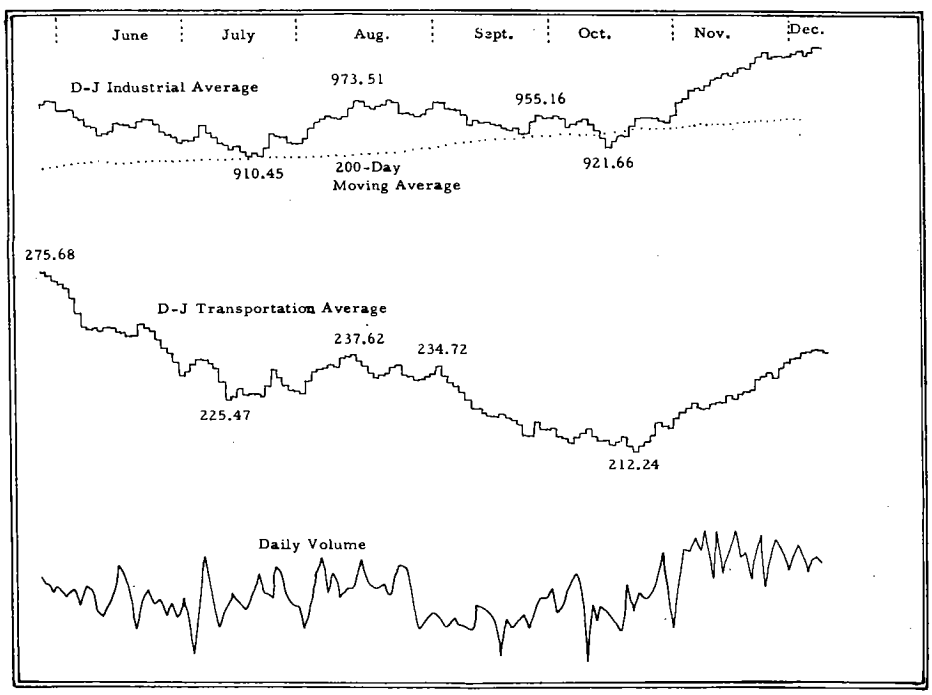
Dec. 1, DJI 1023.93, PTI 1035, A-D ratio -.99
Dec. 8, DJI 1033.19, PTI 1049, A-D ratio -.86

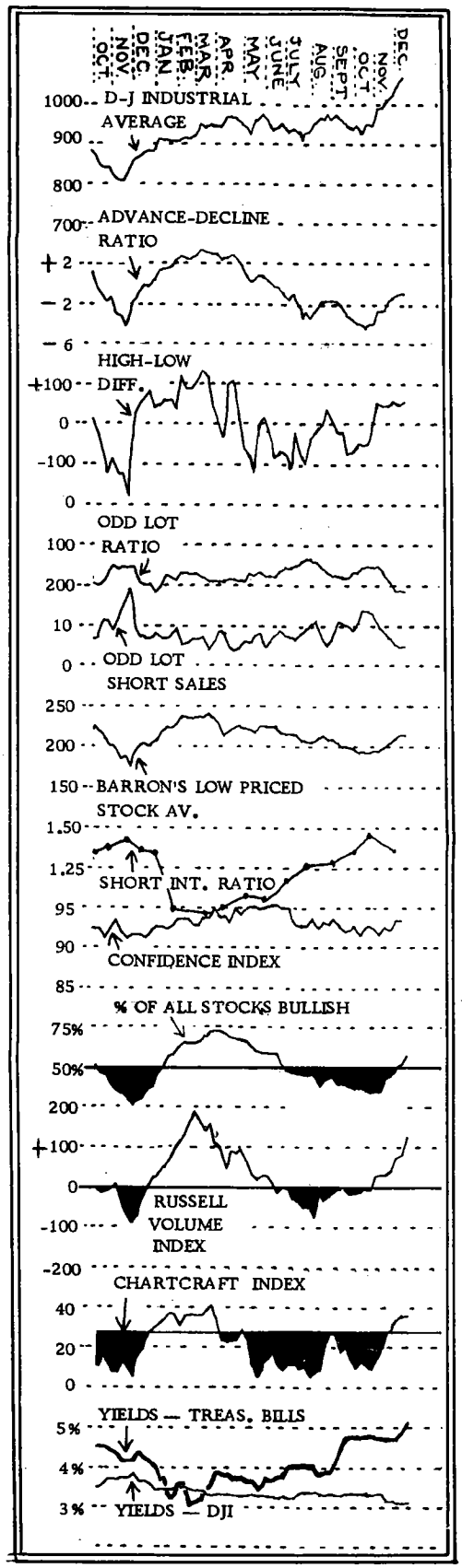
THE MARKET: I have two rather famous friends who are each as intelligent and as market-wise as they come. They are both longtime observers of the Wall Street scene. They have both been writing about the stock market for many years. And they each entertain totally opposing views of this market.

I knew Joe Granville when he was writing the daily market Letter for E. F. Hutton & Co. In my mind (and in the minds of many others) that was the best brokerage daily published before or since. Joe is the originator of many outstanding market methods, perhaps the most famous of which is on-balance-volume (see last page of this report). He has been heading his own investment service for years, and back in the middle '60's, he was smart enough to move to Florida (PO Box 2614, Ormond Beach, FL 32072).

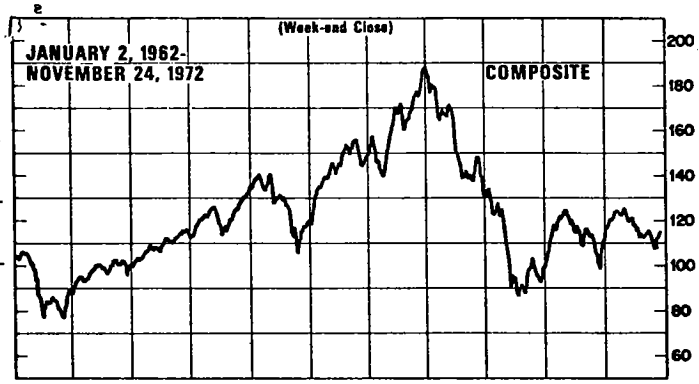
Joe believes that we have been in a bull market since 1970. He feels that the third or speculative phase of that market lies ahead of us, and that we will yet see the public come in, we will yet see the big speculation with strength spreading into the Amex, the over-the-counter and the "cats-and-dogs."

E. George Schaefer (910 E. 38th St, Indianapolis, IN 46205) was writing about his new Dow Theory approach and the market (and being remarkably correct) at a time when most of today's analysts were switching from knickers to long pants. Schaefer was utilizing technical methods (odd lots, moving averages, crowd psychology, short interest) and writing about them in his service during the late 1940's and 1950's--at a time when there literally was no technical analysis. Anyone talking about odd-lot short selling in 1949 (as George was) might as well have been talking about the future of lasar beams.





WEEKLY CHART - VALUE LINE AVERAGES



So Schaefer's credentials and record are superb. His experience and judgment are tops. Schaefer believes that the great bull market which began in 1949 ended in February, 1966. He feels that the 1966 cave-in and more particularly the 1969-70 collaspe were the straws that broke the back of the public's confidence about the stock market. The public was hurt in '66, utterly pulverized during 1969-70. Now they are selling as the market bounces back during what Schaefer terms a manipulated "Keynesian rally" in a bear market. Schaefer feels that the old Rhea-Hamilton definition of secondary reactions cannot hold in this era of mass communication, giant Government propaganda and monetary manipulation. The market can do anything over the intermediate term, but the underlying primary force will hold intact.

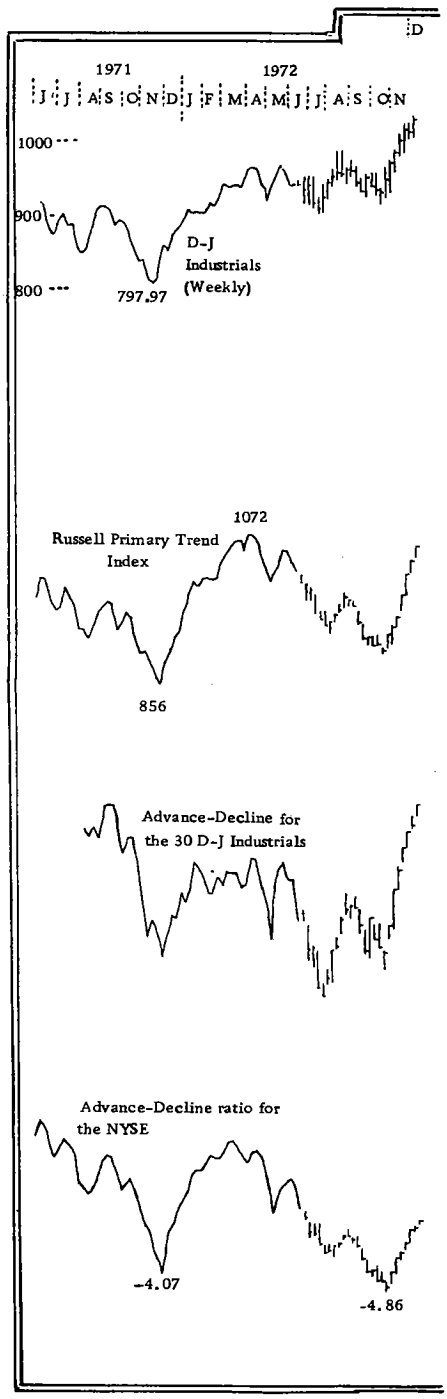
And, says Schaefer, that underlying primary force is still bearish as it has been since 1966. Schaefer says that just as the public was demolished during 1966 and 1969-70, the banks, pension funds and mutual funds are heading for their own Baptism of fire in the coming year or so. Caught in a toppling market, thinks Schaefer, the institutions will be like chaff in the wind, helpless to sell stock in an illiquid market with no public and only themselves (the institutions) able, but not willing, to purchase stocks.

What do I think? In general, I agree with Schaefer. I have been watching Wall Street on a daily (if not hourly) basis for a quarter of a century, and I must say that today's market has a "strange and exotic" feel about it. The fact is that almost all the analysts expect the public to turn around and come back into this market en masse. The public is now spending its head off, it's putting two 10 million unit car years together back to back for the first time, it's setting records for installment buying, but when it comes to Wall Street, the public acts like the proverbial shy, young maiden.

I note that the predictions are almost unanimous for a "good 1973" and even a "happy 1974." Nobody questions the consensus, few are allowing for the unexpected. Yet there remain those nagging discrepancies, such as the Value Line Average (see accompanying chart) which is a geometric average and one that goes a long way towards explaining why the public is not wild about this market. According to Value Line's Average, the market has not recouped even half of its 1969-70 losses. The American public may not know this, but they act as if they "feel it." The public isn't thinking about making money in today's market, it's thinking about its chances of recovering its 1969-70 losses.

Turning to some of the aspects of the immediate market situation, I'd say the strongest thing about this market in my books is the Primary Trend Index (see next section), and the massive odd lot selling (now running at a rate of about two shares sold for every one purchased). The things to watch are the Transports, which on December 4, bettered their August high (see page 1 chart), but which are still far short of their 1972 high of 275.71. Remember, under Dow Theory it is "hopeful" if the two Averages move up together (as Industrials and Transports have been doing), but ultimately they must confirm. That means that Transports must confirm Industrials by rallying above 275.71, and the sooner the better.

The second technical problem is the new highs, which, on a five day basis, are only running in the 60's, really a sick performance considering that the Dow is over 1000. (Obviously, the answer to this one is that the current new high picture is reflecting what Value Line's Average is telling rather that what the Dow or the S & P Averages are indicating.)



Another negative which is now definitely rearing its head is the monetary-interest rate picture and this is detailed in a later section of this report.

PERSPECTIVE: I am including the page 2 chart showing weekly ranges in the Dow Industrials and three of my pet technical indicators. The Primary Trend Index (PTI) is an amalgum of eight important technical indices, including the three Dow common stock averages, the S & P 500 Average, the daily high-lows, the A-D ratio, the most-active stocks and the Dow 40-Bond Average. Thus, the PTI is able to compare the technical condition of the market from one peak to the next, from one low to the next.

On November 18, as noted in Letter 546, the PTI bettered its preceding August peak. This prompted me to state in the last Letter that ". . .a great technical plus has thus been provided by the PTI. . . .When the PTI is strong and bettering previous peaks, it indicates that the broad technical fiber of the market is 'upside and in gear'. . . ."

As seen at the bottom of this chart, the advance-decline ratio followed the lead of the PTI and on November 28 the A-D ratio also bettered its August high. This was the first time since April that the A-D ratio was able to reverse itself with enough power to better a previous important peak.

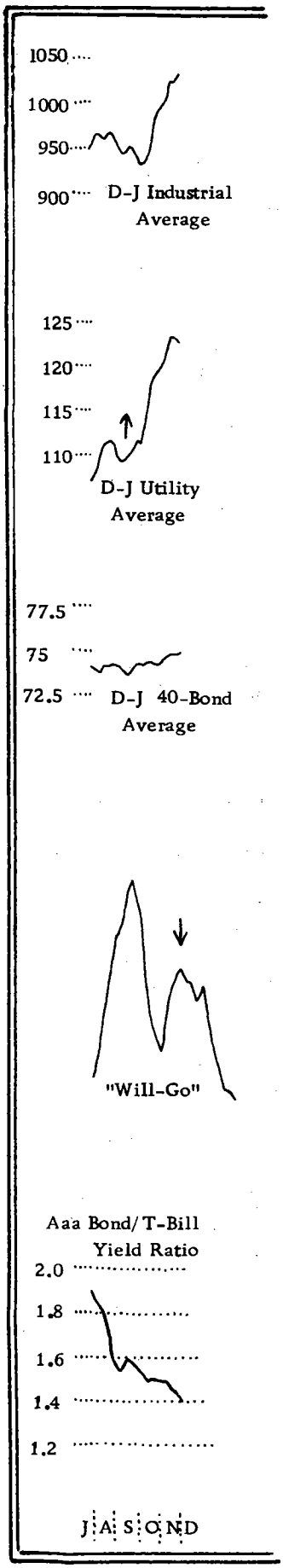
Note that this chart also includes my rather unique A-D index for the 30 Dow Industrial stocks. This index is simply the cumulative plurality of advances or declines in the Dow stocks alone. If, for instance, 10 more Dow stocks advanced than declined on a given day, the figure 10 is added to the previous days total. I might add that all of the indices shown on this chart are computed daily, although the weekly high-low and Thursday close are pictured on the chart.

The Dow A-D ratio is a very interesting tool, and I am still learning about it and how it acts. Note, however, that the confirmation and non-confirmation principle seem to be very important here. For instance, on the sell-off from April to July 1972, the Dow A-D broke to a 1971-72 low, but the Dow Average held firm. This remarkable performance was indicating that price had no intention of following breadth. The aftermath was a sharp rally into recovery high territory for the Dow in August, and then another less drastic decline into October. When the Dow A-D in October exceeded its preceding peak it was as if a spring had been released in the Dow and prices ran over the 995.15 all-time high and then through 1000.

The comparison of the Dow A-D line with the NYSE A-D line is interesting and points up the broadened strength of the Dow with the still relucant strength of the general market. What this picture shows is that the money on this exotic upmove has been made by those who own the better Dow performers, not those who own various NYSE listings. The two A-D lines show that more clearly than any other indices I have seen.

MONEY RATES: A few years back I presented a number of studies on the market and interest rates in terms of a dual indicator which I used. This is the combined trend of the D-J Utility Average and the D-J 40-Bond Average. It was shown that in general, in money-sensitive markets (and this has been a money-sensitive market since the mid-1960's), whenever both the Utility and 40-Bond Averages are advancing together, the atmosphere is favorable for the stock market and prices are most likely to climb. The converse is true whenever the Utility and Bond Averages are declining in unison.

The Utility and Bond Averages had been declining all through early 1972. Utilities hit a low for the year of 105.06 on June 19. But the 40-Bond Average continued to slide. Bonds hit a low of 73.86 on July 28, moved generally sideways through August, and on September 26 the Bonds closed at 73.79. That was the low for the second half of 1972 for the 40-Bond Average. From that point on both the Bonds and the Utilities advanced, and the signal was given for a better stock market. This "up signal" is shown by the little arrow above the Utility Average (see accompanying chart).



 I am adding two more monetary indicators to what will now be termed a "composite monetary chart". The first is an indicator which Larry Williams (the brilliant former publisher of the Williams Report) termed "Will-Go" (because whichever way this indicator points, the market "will go"). The indicator possesses an amazingly accurate record when plotted ten weeks ahead of the Dow as shown on the chart. But it is important to note that Will-Go does not forecast the extent of any market movement--it deals with direction.

Will-Go is very simple to compute. On the "Market Laboratory" page of Barron's under the "Week's Market Statistics" you will see the spread between the yields for Barron's High-Grade Bonds and the D-J Industrial Average. For Will-Go, this figure is compared with the same figure five weeks previous. If it is higher, the figure is added to a cumulative total, if it is lower it is subtracted. Since the figures are all minus's these days, it is important to remember that a larger minus figure is a greater minus quantity than a smaller minus figure. For instance, this week's figure is -4.06 and the figure of five weeks ago was -3.99, the difference is .07, but since -4.06 is further towards the minus side than -3.99, the .07 (actually just 7) is subtracted from the total, and Will-Go will show a decline.

Looking at the chart, Will-Go was in an advancing phase up to the week of October 23, when it hit a high. Since then it has been heading down. Plotting 10 weeks ahead, this suggests that the Dow will advance to Christmas week, then turn down. This is another way of saying that Will-Go is forecasting a decline to start around the opening days of 1973. The declining period is shown by a down-arrow on Will-Go.

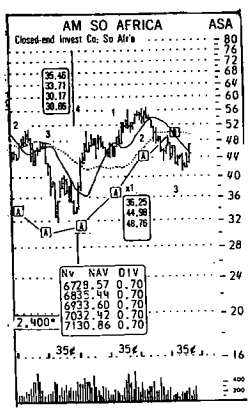
For the last indicator, I am indebted to Stock Market Alert, 189 De La Warr Rd, Bexhill-on-Sea, Sussex, England. This very interesting and valuable indicator is simply the ratio of Aaa Industrial Bond yields and the 91-day Treasury Bill yields (Aaa yields divided by T-Bill yields). The Alert uses a 5-day moving average of the yields to obtain a more representative ratio.

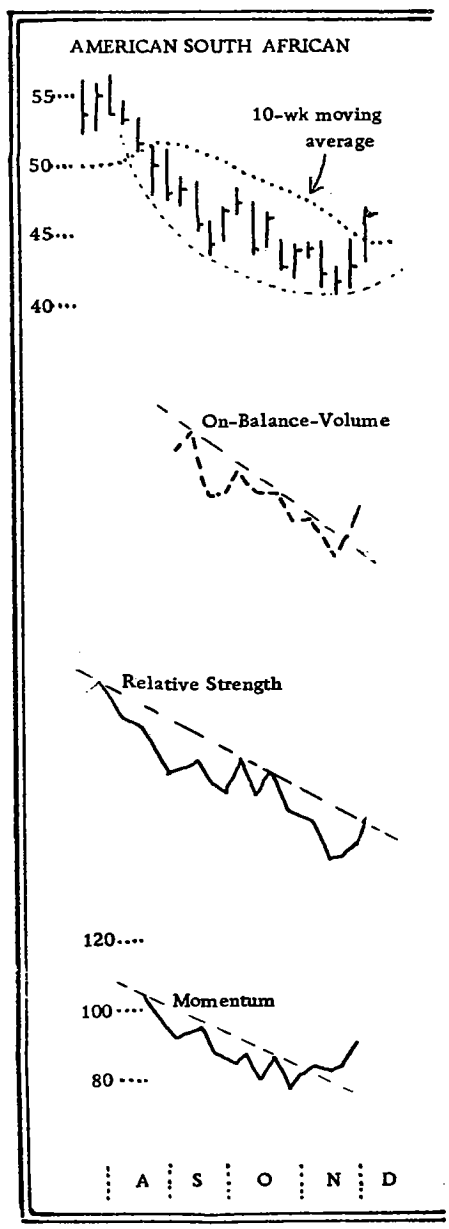
The ratio tends to move between .90 and 2.20. This is how it calls signals. A rise from a low level up through 1.2 is a "buy" signal. A further rise through 1.45 is a "strong buy." A decline from a high figure down below 1.4 is a "sell signal." A further decline below 1.2 is a "strong sell."

In other words, as the spread between the yields on T-Bills and Aaa Industrial Bonds narrows, the situation becomes progressively more dangerous. Theoretically, for instance, if T-Bill rates go through the roof or to the level of Aaa rates, the ratio will be 1.00. This would indicate massive pressure in the sensitive or short-term market and trouble throughout the monetary picture.

Note on the chart that the ratio has been declining over the past six months. This is a picture of increasingly disturbed monetary or credit conditions. Already we have had a boost in stock margin requirements, and T-Bill yields (91-day yields hit 5% on Nov. 8) are at their highest level since the summer of '71. As of this writing, the ratio is at 1.4, literally a hair away from a first "sell signal." This could correspond to the trouble being predicted ahead by Will-Go. I also note that the advance in the Utility and 40-Bond Averages seems to have just about ended. If, over the next few weeks, the Aaa/Bill ratio actually drops below 1.40 and the Utilities and Bonds turn down, I would say that the New Year will be greeted by trouble in both the stock market and the money markets.

MORE ON GOLD: Preparations are being made for 1973's international monetary negotiations in Nairobi. The US has already assumed an incredible position, a position put forth in a 22 page "negotiating document." According to the US paper, if a nation (such as Japan) is a very competitive producer and its foreign reserves are rising rapidly, after a certain build-up, it would be "permitted" to do something to fix the reserve imbalance. If that nation refused to "do something" about its rising reserves, it would be "obliged" to act. If the nation still refuses, then according to the US paper, a penalty (the euphemism used by the US is the word "incentive") would be applied. That penalty would be denial of convertibility of the nation's currency. In fact, even higher penalties could be imposed, such as a surcharge on imports.





Thus, the US has taken the position that the inflating nations (or the nations which cannot compete as measured by its loss of reserves) must be protected against the competitive nations. If a nation is too competitive and it is piling up reserves from less competitive nations, that efficient nation must be penalized.

The problem: how can the US make other nations swallow this outlandish series of proposals? The "carrot" which has been held up is that if this plan is accepted, the US will get together with its creditors in an effort to clean up the $60 billion which is choking foreign central banks. The second carrot is that the US will discuss convertibility of dollars accumulated in foreign central banks. One can only gasp at the sheer affrontery of the US. It's as if one man owes another $10,000, and he says, "Look, Charlie, I've got a new plan for our business arrangements, and if you'll agree to it, I'll discuss with you the idea of my paying you the money I owe you."

I don't know what's in the minds' of our creditors, and I don't know what's in their backbones, but if they have either minds or backbones, then we're liable to see little or no agreements coming out of Nairobi in 1973--we're not even liable to see outlines of plans for agreements.

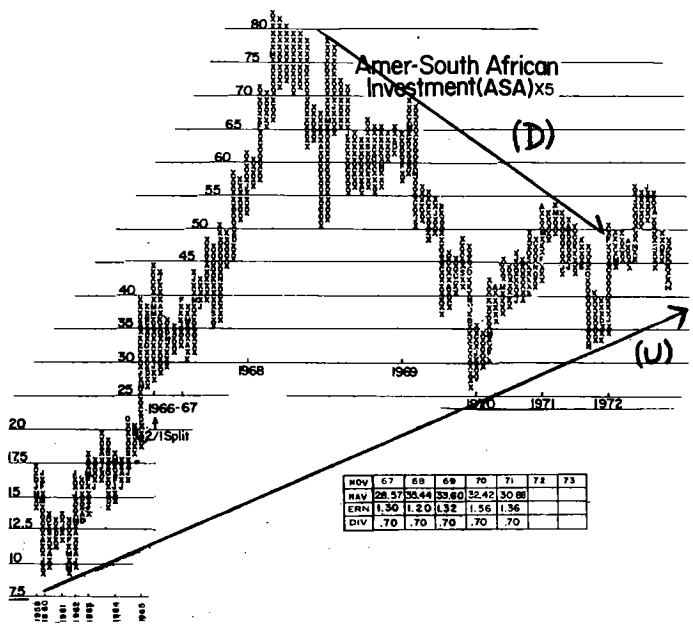
In the meantime, initial pressure is on Japan, which has piled up about $25 billion in dollars and is expected to run a trade surplus of as high as $9 billion with the US this year. It is said that there would have to be a 25% revaluation of the yen in order for the US to be competitive with the Japanese.

A rather large problem looms here. If Japan revalues, speculators will cash in their revaluation bets and pull out. Dollars will leave Japan. Japan keeps most of her dollars in US Treasury bills. If the T-Bills are turned in, interest rates here could go through the roof. This is a situation which will be well worth watching.

But all in all, the picture, as I see it, points to the hopelessness of running the world's monetary system on the machinations, manipulations, promises and hopes of politicians. There is only one monetary item which is immune from politics--gold. So I have no doubts that (as Alden Wells says--see last report), ". . .in time gold will become the foundation of paper money." The fact is that every system must have a solid foundation, whether it is religion, physics, botany or monetary. Since men tend to be greedy, since the public ultimately believes the words of the politicians, since a tree with no roots ultimately topples over, I see gold as the eventual winner in the monetary Russian Roulette game which is sweeping the world.

I showed in the last report how gold bullion price has had every chance to correct and break $60 on the Free Market--but has not. I showed a chart of the S. African gold index, which is now forming a "saucer bottom" preparatory to reversing to the upside. I am including in this mailing a chart of American South African (a NYSE listed issue and a well-managed holding company for S. African shares) which I feel is now in a buying range. ASA is now selling at around asset value, a situation which, in the past, has always constituted an advantageous buying point.

I want to present ASA first from a long-term perspective and here I include a point & figure chart from The Dines Letter (18 E. 41st St, NYC 10017). As I interpret the chart, ASA made a major bull move to its 1968 peak of 84, corrected to the 1970 low of 26, and since then the stock has been building a base for the next potential bull rise.



My own weekly chart (page 4) covers the last six weeks of market action, and here we see some of the most important technical considerations. The stock appears to be building a "saucer bottom," which is a sign of the end of selling and the beginning of slow, steady, accumulation. The 10-week moving average is at $44\frac{1}{2}$, so it is significant that last week ASA closed above the MA for the first time in many months. On-balance-volume is reversing to the upside. ASA is still acting poorer than the market as seen by its relative strength line, but here too a reversal may be in process. Finally, momentum on ASA has turned up, indicating that the stock is now trending above its price of 13 weeks ago.

The little weekly chart of ASA (courtesy of Quote, Box 213, Wichita, KS 67201) shows a longer period of ASA action. It also shows that net asset value of ASA (boxes marked A

connected with lines) is $48.76, indicating that the stock is now selling at net assets. All in all, I would say that long-term commitments is ASA could be assumed at this time.

STOCKS: Standard of Calif. (SD) was mentioned as an outstandingly strong Dow stock in the Letter of October 20. At that time SD was 70. It has since risen above 80, and as seen on the technical chart, SD is still technically very strong. The stock has risen a good distance above its moving average, and such action often calls for a correction back to or near the MA. Note also that the odd-lotters have stopped "fighting" the rise and are now cutting back on their selling (which invariably happens in a stock which persistently advances). For those who bought this stock in the low 70's, part profits might be taken here. The stock is rated 4.

A newcomer to technical strength is American Brands (the old American Tobacco Co. with a new name and new products). OBV has traced out a large bullish (ascending) zig-zag, RS is beginning to rise and momentum is good. After a spate of actual odd-lot buying, the odd-lotters are now selling the rise, which is a technical plus. I rate AMB with a 4.

IBM is shown here because like GM, it is a market bellwether. It is rated 4. Last week it rose above its MA and its OBV registered an upward zig-zag. MO has been moving up mildly over the past four weeks. The odd-lotters have stayed on the buy side of IBM and its RS is hardly inspiring. Thus, I would say that IBM is now looking fair, but the stock lacks the technical sparkle of many of the leading Dow stocks.

LATE NOTES: The yield on 91-Day Treasury Bills has risen to 5.6% today, and the Aaa/Bill yield ratio has dropped to 1.38, thereby rendering a first sell signal. It appears to me that this market is running into increasing resistance with trouble to come at or around the turn of the year.

TECHNICAL CHARTS on the Dow stocks are constructed as follows: Weekly high, low and closing price for each stock is plotted.

(1) Price fluctuates above or below a 10-week moving average (MA) of price. The MA is advanced three weeks in front of price. This is done because the process has been tested and provides the best buy and sell signals.
(2) On-Balance-volume (OBV) is cumulated volume. If a stock rises on a given day, all the volume for that day is considered plus, and is added to the previous day's total. The converse is applied if the stock declines. The Wednesday figure is plotted each week on the chart.
(3) If a short interest exists in the stock, it is shown on the chart.
(4) Relative strength (RS) is a ratio and indicates the stock's action compared with the "market." The market, in this case, is the S & P 500.
(5) The Momentum index (MO) used here is the ratio of the stock's price to its own price 13 weeks ago. Thus, while relative strength (RS) gauges the current performance of the stock against the general market, MO measures the performance of a stock against its own previous level. Important: If the market is declining, rising RS in a stock does not mean that stock is rising, it simply means that the stock is declining less rapidly than the market. But rising MO always means that the stock is actually rising, regardless of the market. Rising RS and MO indicates that not only is the stock outperforming the market, but the stock is trending above its own price of 13 weeks ago. RS tells you what to buy; MO tells you when to buy.
(6) The odd-lot ratio is the ratio of odd-lot buying to selling in the individual stock. These weekly ratios are plotted on the chart in the form of 4-week moving averages. When the odd-lot ratio rises it indicates a move towards selling, a declining line indicates less selling or buying. A ratio of 500 means 500 shares sold for each 100 bought; a ratio of 50 means 50 shares sold for each 100 bought.

Each of the six indicators is worth a point. Stocks are rated from zero (least strength) to 6 (most strength).